

Message Text

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ACTION EB-04

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CONFIDENTIAL MADRID 1147

LIMDIS/GREENBACK

E.O. 11652: GDS
TAGS: EFIN, SP
SUBJECT: EXCHANGE MARKET DEVELOPMENTS

REF: STATE 029600; MADRID 1145 AND 1146

1. MADRID REFTELS PROVIDE AN OVERVIEW OF THE CURRENT ECONOMIC/ FINANCIAL SITUATION AND THE VIEWS OF THE BANK OF SPAIN'S DIRECTOR OF RESEARCH. WE ARE WORKING ON A DETAILED REPORT ON THE 1976 BALANCE OF PAYMENTS OUTCOME, AND ON 1977 AND ONWARD PROJECTIONS. THESE DETAILED REPORTS WILL BE SUBMITTED AS SOON AS POSSIBLE. WE WOULD SIMPLY NOTE HERE THAT THE 1976 CURRENT ACCOUNT DEFICIT IS ESTIMATED TO HAVE BEEN BETWEEN \$4.2 AND \$4.3 BILLION, AND THAT IN VIEW OF THE PETROLEUM PRICE INCREASE OF LATE 1976, LIKELY CONTINUED SPANISH INFLATION IN 1977 AT LEAST AT THE RATE OF 1976, AND SPECULATION AGAINST THE PESETA IN A VARIETY OF WAYS THE 1977 BALANCE OF PAYMENTS DEFICIT STANDS TO BE GREATER THAN IN 1976 UNLESS SOME CORRECTIVE ACTION IS TAKEN.

2. IN THEORY SPAIN COULD FULLY FINANCE A DEFICIT OF \$5 BILLION OR ABOVE IN 1977 THROUGH DRAWING DOWN ITS GOLD AND FOREIGN EXCHANGE RESERVES OF SOME \$4.9 BILLION AT THE END OF 1976 AND BORROWING ADDITIONAL AMOUNTS ABROAD ON TOP OF

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ITS CURRENT ESTIMATED \$12 BILLION IN COMBINED SPECIAL AND PRIVATE FOREIGN DEBT. IN CONNECTION WITH INCREASED DEBT, ALTHOUGH COMMERCIAL BANKS ARE SAID TO BE ASKING INCREASINGLY SHARP QUESTIONS ABOUT THE FUTURE, HIGH-LEVEL SOUNDINGS HAVE BEEN MADE WITH SAUDI ARABIA, KUWAYT AND THE UNITED ARAB EMIRATES THAT SPAIN HOPES MAY YIELD \$1.5 TO \$2 BILLION IN 1977. IN PRACTICE, HOWEVER, THE GOS IS

MORE LIKELY TO TAKE SOME ACTION TO LIMIT THE DEFICIT
BEFORE 1977 IS OUT THAN TO DEPEND ENTIRELY ON RESERVE DRAWDOWN
AND INCREASED BORROWING.

3. THE QUESTIONS ARE, THEN, PRECISELY WHEN THE ACTION WILL BE
TAKEN AND WHAT IT WILL BE, NOT WHETHER THERE WILL BE ACTION (SINCE
SPAIN HAS NO NORTH SEA PETROLEUM OR OTHER DEU EX MACHINA
AVAILABLE TO RESOLVE ITS STRUCTURAL PROBLEMS IN
1977, 1978 OR THE FORESEEABLE FUTURE).

4. EVENTUALLY THERE MUST BE A MAJOR DEPRECIATION OF THE
PESETA RATE, EITHER THROUGH PROGRESSIVE FLOAT DOWNWARD OR
AN ABRUPT DEVALUATION. HOPEFULLY THAT MAJOR CORRECTION
WILL BE ACCCOMPANIED BY AN APPROPRIATE STABILIZATION PRO-
GRAM. AS REPORTED IN REFTELS, MANY KNOWLEDGEABLE SPAN-
ISH BANKERS, BUSINESSMEN, POLITICIANS AND MEDIA REPRE-
SENTATIVES BELIEVE THAT THE GOS SHOULD HAVE ALREADY
EMBARKED ON A STABILIZATION PROGRAM, INCLUDING DEVALUATION,
AND ARGUE THAT, NOT HAVING DONE SO, IT SHOULD DO SO BEFORE
ELECTIONS. WE CANNOT BE CERTAIN OF GOS THINKING AT THE TOP;
BUT ALL THE INDICATIONS WE HAVE THUS FAR ARE, HOWEVER, THAT
IT HOPES TO GET THROUGH THE ELECTIONS EXPECTED IN LATE MAY
WITHOUT MAJOR ACTION. IT HAS PERMITTED THE PESETA TO DRIFT
DOWN SLIGHTLY IN RECENT WEEKS (FROM 68.0 TO THE DOLLAR ON
JANUARY 4 TO 68.8 ON FEBRUARY 3) AND MAY CONTINUE TO PERMIT
GRADUAL MOVEMENT, BUT DOES NOT PRESENTLY APPEAR INCLINED TO
MORE DEFINITIVE ACTION.

5. UNDERSTANDING OF THE BASIC WEAKNESS OF THE PESETA AND
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OF THE INADEQUACY OF GOS ECONOMIC POLICIES THUS FAR IS SUF-
FICIENTLY WIDESPREAD WITHIN SPAIN SO THAT THE GOS MAY BE
FORCED BY A MORE RAPID DETERIORATION OF ITS BALANCE OF PAYMENTS
POSITION, TO GO BEYOND PRESENT INTENTIONS BEFORE MAY. WHETHER
IT WOULD THEN OPT FOR MORE RESTRICTIONS AND CONTROLS (AND PERHAPS
ACVANCE IMPORT DEPOSITS) RATHER THAN A STABILIZATION EFFORT,
INCLUDING DEVALUATION OR AT LEAST MORE RAPID DOWNWARD FLOAT AND
CREDIT RESTRAINT, IS AN OPEN QUESTION; BUT THE NORM FOR GOVERNMENTS
CONCENTRATING ON POLITICS USUALLY IS THE RESTRICTIONS AND CONTROLS
ROUTE.

6. IN THIS SITUATION, IT IS FORTUITOUS THAT AN ANNUAL IMF
CONSULTATIONS MISSION WILL BE IN MADRID FOR TWO WEEKS
BEGINNING FEBRUARY 16. SO FAR AS WE CAN TELL, THE GOS
IS PLANNING THUS FAR TO TREAT THE VISIT OF THIS MISSION AS
A ROUTINE TECHNICAL MATTER. IT WOULD OBVIOUSLY BE BETTER
IF POLICY MAKERS COULD BE BROUGHT TO FOCUS ON ITS FINDINGS. STABLER

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